

Report  
of the  
Examination of  
Farmington Mutual Insurance Company  
Osceola, Wisconsin  
As of December 31, 2000

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# State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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June 29, 2001

Honorable Connie L. O'Connell  
Commissioner of Insurance  
State of Wisconsin  
121 East Wilson Street  
Madison, WI 53702

Commissioner:

In accordance with your instructions, a compliance examination has been made of the  
affairs and financial condition of:

FARMINGTON MUTUAL INSURANCE COMPANY  
Osceola, Wisconsin

and this report is respectfully submitted.

## I. INTRODUCTION

The previous examination of the company was conducted in 1998 as of  
December 31, 1997. The current examination covered the intervening period ending  
December 31, 2000, and included a review of such 2001 transactions as deemed necessary to  
complete the examination.

The examination consisted of a review of all major phases of the company's  
operations, and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Employees' Welfare and Pension Plans
- Territory and Plan of Operations
- Growth of Company

Reinsurance  
Financial Statements  
Accounts and Records  
Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

## II. HISTORY AND PLAN OF OPERATION

The company was organized in 1878, as Farmington Mutual Fire Insurance Company, a town mutual insurer. It changed its name to Farmington Mutual Insurance Company (hereinafter, "Farmington" or "the company") through subsequent amendments to its articles and bylaws. Effective September 16, 1996, Farmington converted from a town mutual insurance company to a nonassessable mutual insurance company under ch. 611, Wis. Stat. Warren Mutual Insurance Company was merged into the company effective January 1, 1997.

The company is authorized to transact the business of insurance in Wisconsin. The company plans limited growth concentrating in the northwestern portion of the state.

The major products marketed by the company include Farmowners', Homeowners', Allied lines, Fire and Commercial lines of business. The major products are marketed through 22 agents, of whom 8 are directors of the company. The company compensates agents for the total annual premium written on the following basis:

Property lines	15%
Liability lines	10%

All policies renew on November 1; renewal commissions are paid on the above basis for the premium in force for the period before year-end, once all renewal premiums are received.

The following table is a summary of the net insurance premiums written by the company in 2000. The growth of the company is discussed in the Financial Data section of this report.

<b>Line of Business</b>	<b>Direct Premium</b>	<b>Reinsurance Assumed</b>	<b>Reinsurance Ceded</b>	<b>Net Premium</b>
Fire	\$ 32,495	\$0	\$ 4,875	\$ 27,620
Allied lines	48,742	0	7,312	41,430
Farmowner's multiple peril	952,496	0	142,898	809,598
Homeowner's multiple peril	303,418	0	45,520	257,898
Commercial multiple peril	<u>16,788</u>	<u>0</u>	<u>2,519</u>	<u>14,269</u>
Total All Lines	<u>\$1,353,939</u>	<u>\$0</u>	<u>\$203,124</u>	<u>\$1,150,815</u>

### III. MANAGEMENT AND CONTROL

#### Board of Directors

The board of directors consists of 8 members and is divided into three classes. One class is elected at each annual meeting for a term of three years. Officers are elected at the board's annual meeting. The board members currently receive \$50.00 per meeting attended and \$0.32 per mile for mileage incurred.

Currently the board of directors consists of the following persons:

<b>Name and Residence</b>	<b>Principal Occupation</b>	<b>Term Expires</b>
Edward Sontag Somerset, WI	Farmer	2002
Phyllis Clark Clear Lake, WI	Insurance Agent	2004
David Neidermire New Richmond, WI	Farmer/Manager	2004
Richard McCurdy St. Croix Falls, WI	Tax Consultant	2003
Henry Heintz Turtle Lake, WI	Retired	2003
John Heintz New Richmond, WI	Retired	2004
Thomas Stack Glenwood City, WI	Insurance Agent/Bus Driver	2002
George Setter Deer Park, WI	Production Worker/Farmer	2001*

\* George Setter retired from the Board at the company's annual meeting in March 2001, his position was left vacant.

All directors act as agents for the company.

### **Officers of the Company**

The officers serving at the time of this examination are as follows:

<b>Name</b>	<b>Office</b>	<b>2000 Compensation</b>
Edward Sontag	President	\$ 0
Phyllis Clark	Vice-President	0
David Neidermire	Secretary/Treasurer	\$42,120

The secretary/treasurer of the company is the only officer who is paid a salary.

Officers of the company are also agents for the company and are paid commissions for the premiums written. For 2000, the president received \$10,632 in commissions, the vice-president received \$15,734 in commissions, and the secretary/treasurer received an additional \$7,508 in commissions.

### **Committees of the Board**

The company's bylaws allow for the formation of certain committees by the board of directors. The company had two committees at the time of the examination: the claims adjusting committee and the investment committee, of which all directors are appointed annually as members to both committees. The board forms special committees when considered necessary. There were no special committees at the time of the examination.

## V. REINSURANCE

The company's reinsurance portfolio and strategy is described below. A list of the companies that have a significant amount of reinsurance in force at the time of the examination follows. The contracts contained proper insolvency provisions.

### Ceding Contracts

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2001, continuous
Termination provisions:	By either party, on any January 1, with 90 days' advanced written notice.

The coverage provided under this treaty are summarized as follows:

- |                                   |   |
|-----------------------------------|---|
| Type of contract:                 | Class A/C-1 Combination Property & Casualty Excess of Loss Reinsurance – First Layer.   |
| Lines reinsured:                  | All property & non-property business written by the company.  |
| Part A – Property Insurance       |   |
| Company's retention:              | \$75,000 each occurrence  |
| Coverage:                         | \$225,000 excess of \$75,000 per risk & per occurrence  |
| Part B – Non-Property Reinsurance |   |
| Company's retention:              | For Policies with Limits at \$100k and less, the retention is \$15,000 per occurrence<br><br>For Policies with Limits above \$100k, the retention is \$25,000 per occurrence  |
| Coverage:                         | For policies with limits up to and at \$100k and less; \$285,000 excess of \$15,000 per occurrence<br><br>For policies with limits above \$100k; \$275,000 excess of \$25,000 per occurrence  |
| Reinsurance premium:              | 5% (minimum) up to 15% (maximum) of the company's net premiums written calculated on a six-year rating period from 2000 to 2005; total loss experience is accumulated since inception and divided by premiums ceded since inception; the ratio is multiplied by 100/80 and is applied to the company's net premiums written since inception; the total reinsurance premium calculated by this method, less premium ceded in prior periods, is payable for the current year's premium subject to the maximum rate. |
- |                   |  |
|-------------------|--|
| Type of contract: | Class A/C-2 Combination Property & Casualty Excess of Loss Reinsurance – Second Layer. |
|-------------------|--|

Lines reinsured:	All property and non-property business written by the company.
Part A – Property Insurance	
Company's retention:	\$300,000 for each occurrence
Coverage:	100% up to \$200,000 per risk
Part B – Non-property reinsurance	
Company's retention:	\$300,000 for each occurrence
Coverage:	100% up to \$700,000 per risk
Reinsurance premium (total):	3% of the company's NPW (minimum of \$40,000)
3. Type of contract:	Class D/E Catastrophe and Stop Loss Reinsurance
Lines reinsured:	All property business written by the company
Part A – Catastrophe Coverage	
Company's retention:	\$150,000 for each loss occurrence
Coverage:	\$250,000 in excess of \$150,000 per loss occurrence
Reinstatement Clause:	Stated that any/all portions of the reinsurance exhausted by the loss, the amount exhausted shall be reinstated immediately by paying a premium calculated as follows: Amount of the occurrence limit being reinstated (based on the loss actually paid by the reinsurer) X 33.34% of the subject reinsurance premium for this coverage (exclusive of reinstatement premium).
Part B – Stop Loss Coverage	
Company's retention:	Combined aggregate losses up to 70% of net premiums written (minimum retention of \$850,000)
Coverage:	100% of the amount exceeding the company's retention level
Reinsurance premium:	6% of the current net written premiums and an annual deposit premium of \$76,000

## **VI. FINANCIAL DATA**

The following financial statements reflect the financial condition of the company as reported in the December 31, 2000, annual statement to the Commissioner of Insurance. Also included in this section are schedules, which reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Members' Surplus per Examination."

**Farmington Mutual Insurance Company**  
**Assets**  
**As of December 31, 2000**

	<b>Ledger Assets</b>	<b>Nonledger Assets</b>	<b>Nonadmitted Assets</b>	<b>Admitted Assets</b>
Bonds	\$1,573,081	\$	\$	\$1,573,081
Stocks:				
Preferred stocks	481,241			481,241
Common stocks	2,355,173			2,355,173
Real estate:				
Occupied by the company	3,543			3,543
Cash	426,339			426,339
Short-term investments	89,179			89,179
Agents' balances or uncollected premiums:				
Premiums and agents' balances in course of collection	230,133			230,133
Interest, dividends, and real estate income due and accrued		29,636		29,636
Other assets nonadmitted:				
Equipment, furniture, and supplies	6,924		6,924	
Write-ins for other than invested assets:				
Note Receivable	2,584		2,584	
	<hr/>	<hr/>	<hr/>	<hr/>
Total Assets	<u>\$5,168,197</u>	<u>\$29,636</u>	<u>\$9,508</u>	<u>\$5,188,325</u>

**Farmington Mutual Insurance Company**  
**Liabilities, Surplus, and Other Funds**  
**As of December 31, 2000**

Losses	\$ 220,711
Loss adjustment expenses	11,423
Taxes, licenses, and fees (excluding federal and foreign income taxes)	7,280
Federal and foreign income taxes (excluding deferred taxes)	3,500
Unearned premiums	<u>1,086,586</u>
Total Liabilities	1,329,825
Unassigned funds (surplus)	<u>3,858,825</u>
Surplus as Regards Policyholders	<u>3,858,825</u>
Total Liabilities, Surplus, and Other Funds	<u>\$5,188,325</u>

**Farmington Mutual Insurance Company**  
**Summary of Operations**  
**For the Year 2000**

**Underwriting Income**

Premiums earned	\$1,067,600
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**Deductions**

Losses incurred	655,430
Loss expenses incurred	33,888
Other underwriting expenses incurred	<u>359,707</u>

Total underwriting deductions	<u>1,049,025</u>
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Net underwriting Gain	18,575
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**Investment Income**

Net investment income earned	198,346
Net realized capital gains or losses	<u>(62,239)</u>
Net investment gain or loss	136,107

**Other Income**

Write-ins for miscellaneous income:	
Miscellaneous Income	<u>2,370</u>
Total other income	<u>2,370</u>

Net income before dividends to policyholders and before federal and foreign income taxes	157,052
Dividends to policyholders	<u>0</u>

Net income after dividends to policyholders but before federal and foreign income taxes	157,052
Federal and foreign income taxes incurred	<u>3,500</u>

Net Income	<u><u>\$153,552</u></u>
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**Farmington Mutual Insurance Company**  
**Cash Flow**  
**As of December 31, 2000**

Premiums collected net of reinsurance	\$1,134,837	
Loss and loss adjustment expenses paid (net of salvage or subrogation)	(673,750)	
Underwriting expenses paid	(369,393)	
Other underwriting income (expenses)	<u>1,646</u>	
Cash from underwriting		\$93,340
Investment income (net of investment expense)		181,586
Other income (expenses):		
Write-ins for miscellaneous items:		
Miscellaneous Income	<u>2,370</u>	
Total other income	<u>2,370</u>	
Deduct:		
Federal income taxes paid (recovered)		<u>60,000</u>
Net cash from operations		\$337,296
Proceeds from investments sold, matured, or repaid:		
Bonds	538,323	
Stocks	1,604,260	
Miscellaneous proceeds	<u>18,798</u>	
Total investment proceeds		2,161,381
Cost of investments acquired (long-term only):		
Bonds	961,399	
Stocks	<u>1,765,344</u>	
Total investments acquired		<u>2,726,743</u>
Net cash from investments		<u>(565,362)</u>
Net change in cash and short-term investments		(228,066)
<b>Reconciliation</b>		
Cash and short-term investments, December 31, 1999		<u>743,584</u>
Cash and short-term investments, December 31, 2000		<u>\$515,518</u>

**Farmington Mutual Insurance Company  
Compulsory and Security Surplus Calculation  
December 31, 2000**

Assets		\$5,188,325	
Less liabilities		<u>1,329,500</u>	
Adjusted surplus			\$3,858,825
Annual premium:			
All other insurance	\$1,150,815		
Factor	<u>20%</u>		
Total		<u>230,163</u>	
Compulsory surplus (subject to a minimum of \$2 million)			<u>2,000,000</u>
Compulsory surplus excess (or deficit)			<u>\$1,858,825</u>
Adjusted surplus			\$3,858,825
Security surplus: (140% of compulsory surplus, factor reduced 1% for each \$33 million in premium written in excess of \$10 million with a minimum of 110%)			<u>2,800,000</u>
Security surplus excess (or deficit)			<u>\$1,058,825</u>

**Farmington Mutual Insurance Company  
Reconciliation and Analysis of Surplus  
For the Three-Year Period Ending December 31, 2000**

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	<b>1998</b>	<b>1999</b>	<b>2000</b>
Surplus, beginning of year	\$3,544,374	\$3,625,832	\$3,848,051
Net income	6,263	222,417	153,552
Net unrealized capital gains or (losses)	66,795	(3,763)	(163,027)
Change in nonadmitted assets	8,400	3,565	20,249
Surplus, end of year	<u>\$3,625,832</u>	<u>\$3,848,051</u>	<u>\$3,858,825</u>

**Farmington Mutual Insurance Company  
Insurance Regulatory Information System  
For the Three-Year Period Ending December 31, 2000**

The following is a summary of NAIC Insurance Regulatory Information System (IRIS) results for the period under examination.

<b>Ratio</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>
#1 Gross Premium to Surplus	35%	36%	35%
#1A Net Premium to Surplus	30	30	30
#2 Change in Net Writings	-13	3	1
#3 Surplus Aid to Surplus	0	0	0
#4 Two-Year Overall Operating Ratio	84	91	81
#5 Investment Yield	4*	3.7*	4.1*
#6 Change in Surplus	-2	7	1
#7 Liabilities to Liquid Assets	24	23	28
#8 Agents' Balances to Surplus	0	0	7
#9 One-Year Reserve Devel. to Surplus	0	-26	2
#10 Two-Year Reserve Devel. to Surplus	0	-17	-2
#11 Estimated Current Reserve Def. To Surplus	1	-19	0

IRIS ratio #5, which is the investment yield, has been below average for the past three years due to the company's under-performing investment portfolio. There are further comments on investment performance in the Invested Assets section of this report.

### Growth of Farmington Mutual Insurance Company

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income
1998	\$4,767,108	\$1,141,276	\$3,625,832	\$ 6,263
1999	5,031,144	1,183,093	3,848,051	222,417
2000	5,188,325	1,329,500	3,858,825	153,552

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss And LAE Ratio	Expense Ratio	Combined Ratio
1998	\$1,267,129	\$1,103,079	\$1,061,359	89.5%	26.3%	115.8%
1999	1,384,973	1,141,097	1,059,537	71.9	28	99.9
2000	1,353,939	1,150,815	1,067,600	64.6	31.1	95.7

Since the prior examination assets have steadily increased, surplus has increased over the past three years, and net income has been realized in each of the past three years. Gross premium written has increased 6.9% since 1998 to its current amount of \$1,353,939 and premium earned has remained steady over the three-year period with it's current amount at \$1,067,600. The company has a fairly low expense ratio, averaging 28.5% over the past three years. However, the loss ratio and combined ratio were relatively high in 1998 and 1999 compared to other companies of this size.

## Reconciliation of Surplus per Examination

The following schedule is a reconciliation of members' surplus between that reported by the company and as determined by this examination:

Surplus December 31, 2000, per annual statement			\$3,858,825
	<b>Increase</b>	<b>Decrease</b>	
Bonds	\$	\$ 10,904	
Common Stocks		484,810	
Preferred Stocks		515	
Unearned Premiums		34,711	
EDP Equipment	3,347		
Unassigned Funds (worthless securities)		12,940	
Unassigned Funds (commission expense)		35,997	
Unpaid Losses (loss reserve deficiency)		97,385	
Unpaid Losses (IBNR reserve deficiency)		<u>41,500</u>	
Net decrease	<u>\$3,347</u>	<u>\$282,762</u>	<u>(279,415)</u>
Surplus December 31, 2000, per examination			<u>\$3,579,410</u>

## Examination Reclassifications

	<b>Debit</b>	<b>Credit</b>
Short-Term Investment	\$	\$ 89,179
Common Stocks	89,179	
Premiums in the Course of Collection		233,508
Premiums Booked but Deferred	233,508	
Furniture and Equipment		3,347
EDP Equipment	3,347	
Taxes, Licenses & Fees		4,205
Amounts Withheld for Others	<u>4,205</u>	
Total reclassifications	<u>\$330,239</u>	<u>\$330,239</u>

## VII. SUMMARY OF EXAMINATION RESULTS

### Compliance with Prior Examination Report Recommendations

There were 30 specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Annual Statement—It is recommended that the company properly complete and include all required information on all future annual statements.

Action—Noncompliance, see comments in the “Summary of Current Examination Results” section of this report

2. Corporate Records—It is recommended that minutes for all committees of the board of directors be maintained and included with the minutes of the board of directors meetings.

Action—Compliance

3. Corporate Records—It is recommended that, in accordance with ss.612.18 and 611.60, Wis. Stat., directors with a material interest in the matter being discussed by the board abstain from voting on the issue and that this abstention be noted in the minutes of the meeting.

Action—Compliance

4. Management and Control—It is recommended that the company more adequately segregate the performance of the daily activities of the company in order to mitigate this internal control weakness.

Action—Noncompliance, see comments in the “Summary of Current Examination Results” section of this report.

5. Business Plan—It is suggested that the company update its business plan and implement a budget; both of which should be periodically reviewed and approved by the board of directors.

Action—Compliance

6. Disaster Recovery Plan—It is recommended that the company determines the recoverability of backed-up data; and reviews and revises its disaster recovery plan to document such back-up procedures. The disaster recovery plan should cover all company operation both automated and manual, and document all back-up and recovery procedures.

Action—Compliance

7. Underwriting—It is recommended that the company develop underwriting guidelines that set forth the properties and items it will insure.

Action—Compliance

8. Underwriting—It is recommended that the company establish a formal written inspection procedure, which would include information to be included with each policy submitted.

Action—Compliance

9. Actuarial Opinion—It is recommended that the company properly complete the Actuarial Opinion in accordance with the guidelines of the NAIC Annual Statement Instructions – Property and Casualty.

Action—Compliance

10. Accounts and Records—It is recommended that the company require either that two signatures be required for all checks exceeding an amount established by the board and/or checks over a certain amount be reviewed and approved for issuance by the board.

Action—Noncompliance, see comments in the “Summary of Current Examination Results” section of this report.

11. Accounts and Records—It is recommended that the company establish guidelines for the specific uses of this credit card and that the board makes periodic reviews of the usage thereof.

Action—Compliance

12. Invested Assets—It is again recommended that the company comply with s. 610.23, Wis. Stat., as regards custody and control of its invested assets.

Action—Noncompliance, see comments in the “Summary of Current Examination Results” section of this report.

13. Invested Assets—It is further recommended that the custodial/safekeeping agreement entered into include the requirements as established by the NAIC Examiners Handbook, which include the following:
- a) The custodian is required to hold securities separate and distinct from the other deposits with the custodian so that at all times they may be identified as belonging solely to Farmington Mutual Insurance Company;
  - b) The custodian is obligated to indemnify the company for any loss of securities of the insurance company in the bank or banking and trust company’s custody occasioned by the negligence or dishonesty of the bank or banking and trust company’s officers or employees, or including loss by damage or destruction; and
  - c) In the event that there is a loss of the securities for which the bank or banking and trust company is obligated to indemnify the company, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced.

Action—Partial compliance, see comments in the “Summary of Current Examination Results” section of this report.

14. Invested Assets—It is recommended that the company list the name of the individual broker on Schedule D Parts 3,4, or 5.

Action—Compliance

15. Invested Assets—It is recommended that the company maintain adequate documentation whereby justification for the rating assigned to the investment can be ascertained.

Action—Noncompliance, see comments in the “Summary of Current Examination Results” section of this report.

16. Invested Assets—It is recommended that the company submit the proper filings, for all securities acquired by the company since the time of the conversion, to the NAIC Securities Valuation Office for those securities not listed in the Valuations of Securities manual.

Action—Noncompliance, see comments in the “Summary of Current Examination Results” section of this report.

17. Invested Assets—It is recommended that the company establish a formal written plan for the company’s investments.

Action—Noncompliance, see comments in the “Summary of Current Examination Results” section of this report.

18. Invested Assets—It is suggested that the board of directors appoint an investment committee to oversee the investments of the company.

Action—Compliance

19. Common Stocks—It is recommended that the company report money market accounts on Schedule DA of the annual statement in accordance with the NAIC’s Annual Statement Instructions-Property and Casualty.

Action—Compliance

20. Bonds—It is recommended that the company properly report all bonds held by the company, even if in default, in accordance with the NAIC’s Annual Statement Instructions-Property and Casualty.

Action—Noncompliance, see comments in the “Summary of Current Examination Results” section of this report.

21. Cash Advances—It is recommended the company establish a written policy for issuing advances to agents.

Action—Compliance

22. Cash Advances—It is also recommended that a written agreement be executed between the parties with respect to cash advances to agents.

Action—Compliance

23. Mortgage Loans—It is recommended that the company properly classify all personal loans as a write-in line item, loans on personal security, on all future annual statements.

Action—Compliance

24. Net Unpaid Losses—It is recommended that the reinsurer’s estimates for liability reserves be reviewed as part of establishing the company’s liability reserve estimates.

Action—Compliance

25. Net Unpaid Losses—It is recommended that the company establish a formal procedure for estimating IBNR reserves.

Action—Compliance

26. Net Unpaid Losses—It is recommended that the company maintain separate claim files for each claim made against the company and that these claim files and all related documentation be kept separate from other cash disbursements of the company.

Action—Noncompliance, see comments in the “Summary of Current Examination Results” section of this report.

27. Net Unpaid Losses—It is recommended that in the claim files maintained by the company, sufficient documentation be maintained to justify payment of that claim. This documentation should include, but is not limited to, the date the claim was reported, the date of loss, the validity of the policy in force, proof of coverage for the loss, the date the claim was paid, and documentation justifying the payment of the claim or if closed without payment, reason for such a closure. The documentation for justifying the payment could include written description from the adjuster stating what the loss was and how the amount to be paid was determined. The documentation should also include expenses of the agent/adjuster in inspecting the claim.

Action—Compliance

28. Unpaid Loss Adjustment Expenses—It is recommended that the company establish a reserve for unpaid loss adjustment expenses on all future annual statements.

Action—Compliance

29. Taxes, Licenses, and Fees—It is recommended that the company properly complete the fire dues worksheet for all future annual statement filings.

Action—Compliance

30. Other Expenses—It is recommended that the company properly report amounts withheld for others in accordance with the NAIC’s Annual Statement Instructions-Property and Casualty on all future annual statements.

Action—Noncompliance, see comments in the “Summary of Current Examination Results” section of this report.

## **Summary of Current Examination Results**

### **Annual Statement**

A number of items were not included or answered correctly in the company's 2000 annual statement filing. The following is a list of the missing or incorrect information:

- a) The company did not include note #8 in the "notes to the financial statement" section concerning capital notes. According to the annual statement instructions their should be 29 notes, the company only included 28 notes.
- b) The company responded "No" to General Interrogatory #19, concerning securities owned by the company that are not in the actual possession of the company, but failed to provide an explanation as required.

The above items do not include the misstated information found in the investment schedules of the annual statement. These will be covered in the various investment section of the report. It is again recommended that the company properly complete and include all required information on all future annual statements.

### **Management and Control**

It was noted that each year's CPA management letters for the period under examination indicated an inherent weakness in the internal control structure of the company due to the lack of segregation of duties. The company has two employees, which imposes limitations on the amount of segregation that can exist; however, the manager performs the majority of the daily operations. This includes the writing and signing of all checks, reconciliation of the checking account, review of all disbursements made, and investment decisions, among other activities. It is again recommended that the company more adequately segregate the performance of the daily activities of the company in order to mitigate this internal control weakness.

The current manager has been in the position for almost two years. For the year ending December 31, 2000 the company recorded its first underwriting gain in over five years. However, there are a number of improvements that the company needs to address concerning internal controls, record keeping, documentation procedures, use of computers, management and control of investments, etc., as discussed in this report. This would be an opportunity for the

company to hire an additional employee, who is computer literate and has an accounting background, to help alleviate some of the items mentioned above. According to the company's business plan, they expect to increase surplus by \$156,000 per year for the next 15 years, increase writing business within the eight counties they already write in and expand their territory into surrounding counties. It would be beneficial for a company intending to grow and expand its territory to hire a third employee to assist in the processing required for the expected increase in business. It is recommended that the company evaluate its internal controls structure and the capacity of current employees to handle additional work, and consider establishing an additional position with duties in accounting and computer systems.

### **Underwriting**

The company hasn't changed its rates since prior to the last examination. It is important for a company to regularly review its rates based on its loss experience, expenses, and consider its competitors' rates. It is suggested that the company review its rates annually, and regularly review competitors' rates as part of that process.

The examiners' review of the company's inspection procedures for new and renewal business appears to be adequate and in compliance with the prior recommendation. However, there were no photographs of the insured properties included in the policy files. Maintaining photographs of the property that is being insured (for both new and renewal business), would assist management's evaluation of the condition and value of each property. It is recommended that the company begin a requirement for submission of photographs with all applications and on inspected risks.

A review of the company's policy reporting practices from their agents was performed. Per discussion with the company manager, there are instances where an agent writes a new policy but does not notify the company for several months. It appears that the company does not require its agents to comply with the rules in the agents manual including the rule that new policies are to be sent into the office in a timely manner. It is recommended that the company enforce agents' compliance with guidelines set forth in the agency manual concerning the reporting of newly written policies.

## **Accounts and Records**

In reviewing the controls, for the prior recommendation, the company has over the receipt and disbursement of cash, it was again noted that the manager is the only authorized check signer for the company, and only one signature is required on all checks issued by the company regardless of amount. The manager is also the only person to reconcile the checking account. This is an unacceptable internal control deficiency. It is again recommended that the company require that two signatures are required for all checks exceeding an amount established by the board. It is recommended that someone other than the manager reviews each month's reconciliation of the checking account, pursuant to s. 601.42(3), Wis. Stat.

## **Cash and Short-Term Investments**

Review of Schedule DA – Part 1 in the Annual Statement revealed that several of the Money Market Mutual Funds listed were not on the NAIC Securities Valuation Office's "U.S. Direct Obligations Exempt List" or the "U.S. Direct Obligations/Full Faith & Credit Exempt List," or the "Class 1 List." Therefore, the following money market funds, which were not listed on any of the above lists should have been reported on Schedule D – Part 2 (common stock) of the Annual Statement as opposed to Schedule DA – Part 1 (short-term investments): Dain Rauscher Great Hall Prime, Dean Witter Cash Fund, LIR Premier Money Market Fund, Paine Weber Cash Fund and Smith Barney Money Market Fund. A reclassification of \$89,179 was made from the Cash and Short-term investment balance to the Common Stock balance. It is then recommended that money market funds that are not found on the NAIC Securities Valuation Office's "U.S. Direct Obligations Exempt List," the "U.S. Direct Obligations/Full Faith & Credit Exempt List," or the "Class 1 List" be listed on Schedule D – Part 2 on the Annual Statement in accordance with the NAIC's Annual Statement Instructions-Property and Casualty.

## **Unclaimed Funds**

The examiners' review of the bank reconciliations revealed that the company has not established a liability for long outstanding checks and does not have an escheats procedure in place. It is recommended that the company comply with ch. 177, Wis. Stat., as regards

unclaimed funds, and that a liability for unclaimed funds be established in future statutory annual statements to account for all checks outstanding for over one year.

## **Invested Assets**

### **Custody**

The two prior examinations repeated a recommendation that the company comply with s. 610.23, Wis. Stat., on the custody and control of its invested assets. The company has not complied with this recommendation. Ten brokerage firms hold 71% (\$3,127,583.25) of its invested assets. Second, of that \$3,127,583.25, about 40.7% (\$1,273,075.64) is held under a custodial agreement with a trust company. The trust company is an affiliate of one of the company's brokerage firms. The agreement authorizes the trust company to establish and maintain the securities in an account with the affiliated brokerage firm. The trust agreement does not satisfy Wisconsin requirements for the following reasons:

- 1) The agreement was not signed by a representative from the trust company
- 2) The agreement does not indemnify the company for all situations where losses are caused by the broker.

Therefore, it is again recommended that the company comply with s. 610.23, Wis. Stat., on the custody and control of its invested assets. It is also recommended that, within 30 days of the adoption of this report, the company open a custodial account that has been approved by this office, and within 60 days of the adoption of this report all securities held by brokers and held in the current trust account be transferred to the new custodial account. It is further recommended that the custodial/safekeeping agreement entered into include the requirements as established by the NAIC

Examiners Handbook, which include the following:

- a) The custodian is required to hold securities separate and distinct from the other deposits with the custodian so that at all times they may be identified as belonging solely to Farmington Mutual Insurance Company;
- b) The custodian is obligated to indemnify the company for any loss of securities of the insurance company in the bank or banking and trust company's custody occasioned by the negligence or dishonesty of the bank or banking and trust company's officers or employees, or burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damage or destruction; and
- c) In the event that there is a loss of the securities for which the bank or banking and trust company is obligated to indemnify the company, the securities shall be promptly replaced or the value of the securities and the

value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced.

### **Compliance with NAIC SVO Procedures**

The company is required to prepare its annual statement in compliance with NAIC instructions and procedures, including the NAIC SVO procedures for reporting the values of stocks and bonds, and the appropriate credit quality designations for bonds. It was noted that the majority of the securities on Schedule D (specifically Part 1- Bonds) were "NR"-designated. This is not a designation according to the NAIC. "NR" is a symbol used in the VOS publications for bonds and communicates that the information required to arrive at a NAIC Designation is not available to the SVO or that such information was received too late to be processed and reflected in the most current VOS publication. According to the NAIC, this symbol should not be used when designating a bond. Instead the designation of "PE" (Provisionally Exempt), used with an NAIC designation of 1 or 2, could have been used if the security fit the SVO guidelines as follows:

- 1) The reported security meets the criteria set forth in Part 4, Section 1(a)(ii) of the SVO manual. This states that a security may be designated "PE" if rated and monitored by two or more Nationally Recognized Service Rating Organizations (NRSRO), with no lower rating than the equivalent of an NAIC 2 designation by any of the NRSROs, or rated and monitored by only one NRSRO, with a rating the equivalent of an NAIC 1 designation
- 2) And the NAIC designation arrived at by the insurer by converting the NRSRO rating(s) into a corresponding NAIC designation is in accordance with the SVO manual

The company used the "PE" designation for some bonds, however the company could not document and justify the use of this rating. Therefore, it is again recommended that the company maintain adequate documentation whereby justification for the rating assigned to the investment can be ascertained. Furthermore it is again recommended that the company submit the proper filings, for all securities, on Schedule D in the Annual Statement, acquired by the company since the time of the conversion, to the NAIC Securities Valuation Office for those securities not listed in the Valuations of Securities manual.

### **Control of Securities**

It was noted that a number of misstatements were made on the Annual Statement concerning securities. The following misstatements were found: 1) four stocks and one bond listed in the annual statement could not be traced to a custodial statement, brokers' statements,

bank holdings, securities held in the office etc., 2) when reviewing the company's safety deposit box and office safe four stocks were found that were not listed in the annual statement, 3) the number of shares reported by the company conflicted with number of shares stated on support documents for one issue of stock, 4) seven stocks' valuations listed on the annual statement conflicted with rates in the SVO manual, and 5) two stocks were in unsettled trades at year-end and receivable/payable balances should have been set up for them. Instead the company recorded the two transactions as completed.

Therefore a net adjustment of \$60,228.69 was made to surplus concerning the above issues. The following is a chart that breakdown what was mentioned above:

Description	Shares	Company Rate	Exam or SVO Rate	Company Value	Exam or SVO Value	Exam Adjustment
<b>Preferred Stocks</b>						
4)WI Public Service	100	92.875	104.625	9,287.50	10,462.50	1,175.00
4)Can Occ (NEXEN)	1000	24.437	23.06	24,437.00	23,060.00	(1,377.00)
4)Citigroup	1000	25.313	25	25,313.00	25,000.00	(313.00)
Total:						(515.00)
<b>Common Stocks</b>						
1)Alliant Energy	342	31.875	0	10,901.25	0.00	(10,901.25)
2)Avaya	41	0	10.312	0.00	422.79	422.79
3)Bellsouth	952	40.938	40.938	38,972.98	19,486.00	(19,486.98)
5)BEST BUY	300	0	27.625	0.00	8,287.50	8,287.50
4)Cendant Corp Income	1000	16.375	13.63	16,375.00	13,630.00	(2,745.00)
4)Cendant Corp Income	1000	21.75	13.63	21,750.00	13,630.00	(8,120.00)
2)Citigroup	500	0	25.31	0.00	12,655.00	12,655.00
1)Electroscope	2500	1.563	0	3,907.50	0.00	(3,907.50)
2)Encision	2500	0	0.35	0.00	875.00	875.00
1)Mercury Finance	12000	0.12	0	1,440.00	0.00	(1,440.00)
2)MFN Financial	35	0	4.5	0.00	157.50	157.50
4)NM Hold (stockwalk.com)	1375	7.187	2.125	9,882.13	2,921.88	(6,960.25)
4)PLM Equip. Growth Fund	500	9.75	0.72	4,875.00	360.00	(4,515.00)
5)Stockwalk.com	2000	2.125	2.438	4,250.00	(4,875.00)	(9,125.00)
1)Universal Int	1500	2.671	0	4,006.50	0.00	(4,006.50)
Total:						(48,809.69)
<b>Bonds</b>						
1)St. Paul Housing				10,904.00	0.00	(10,904.00)
Total:						
Total Adjustment						(60,228.69)

It is recommended that the company create a system to accurately monitor and record investment transactions, reconcile company investment records to custodial accounts monthly, and correctly report the number of shares owned and correct NAIC SVO values on the annual statement.

#### **Disposal of worthless securities**

Examiners' noted some problems in Schedule D – Part 4 (Disposals) of the annual statement. The company's investment plan includes holding common stocks that continue to decline in value, and in some cases the issuer has declared bankruptcy or the stocks otherwise become worthless. To recognize the realized investment loss in the annual statement, the company reports that it sold securities to itself at zero value in order to recognize the loss. This is an improper way to document this transaction. The proper way to write off the security from the annual statement is to place the words "written off" in the "Name of Purchaser column in Schedule D – Part 4 of the annual statement.

It was also noted that two of the securities that the company had written off in this schedule stated profits on disposal. When taking a security with any value off the books as a write-off, the security must be written down to zero, therefore a gain on the disposal of that security is not possible. An adjustment to decrease surplus was made for \$12,940 for those recognized gains for write-off items. It is recommended that the company complete Schedule D – Part 4 correctly for write-offs of worthless securities in all future annual statements.

#### **Investment plan and performance evaluation**

The company's investment plan was reviewed. The current investment plan was included in the December 8, 1999 Investment Committee minutes and stated the following: "In the stock market maybe 1/3 in large caps, 1/3 in medium caps and 1/3 in small caps." There is no mention of the investment strategy followed by the company and overall it is too vague to be a meaningful investment policy.

It was noted that the company Manager made all the investment decisions that are then approved by the board of directors at the monthly board meetings. The manager deals directly with the brokers, tracks the company's securities and decides when to sell securities. The

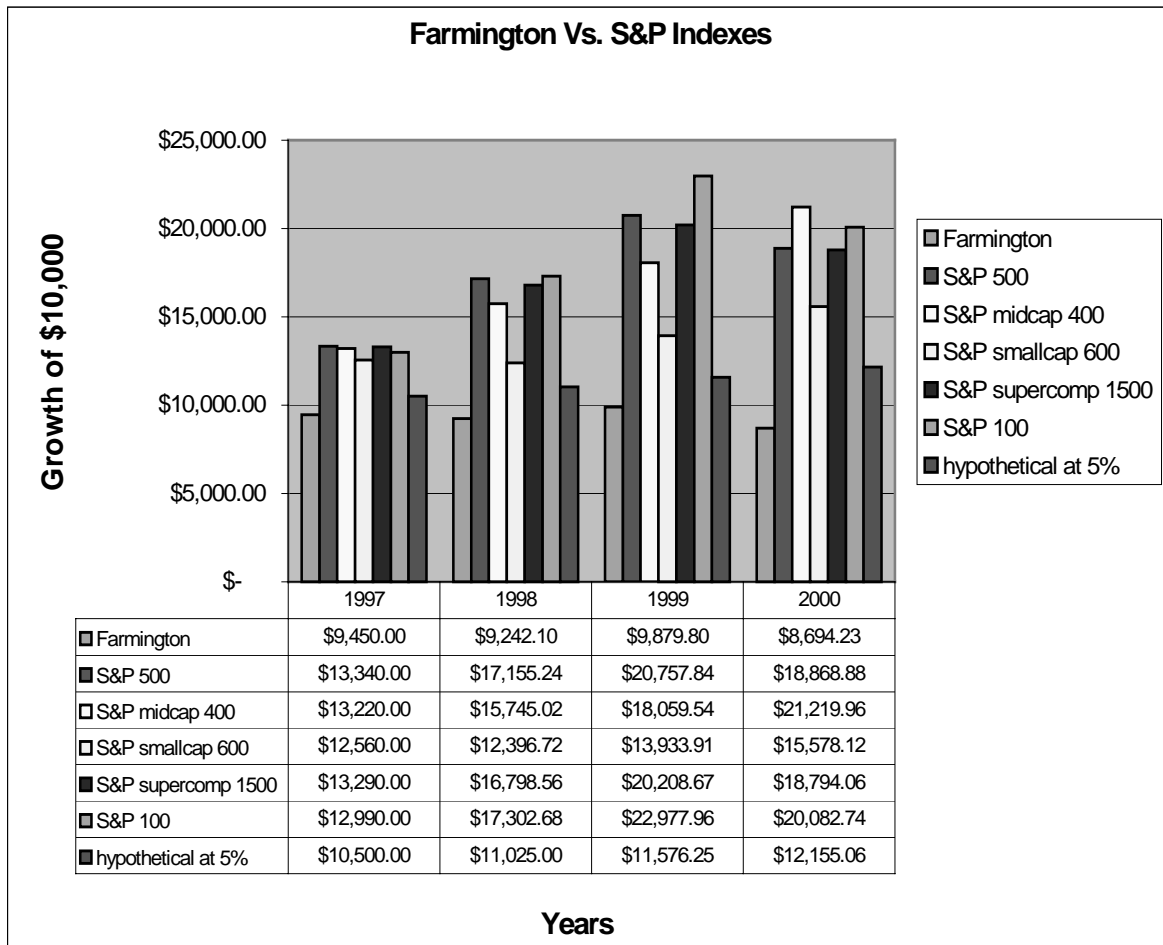
manager's investment philosophy is as follows: sell a stock when it gains a 20% return or more, buy more stock when the price of the stock decreases, to take advantage of stock cost averaging and seldom dispose of stocks when they go down as the down side risk is small. The manager has controlled the investments since September 1999.

Due to the company's adverse investment returns, it is again recommended that the company establish a formal written plan for the company's investments. This investment plan should include, but is not limited to, the following:

- The types of investments allowed by the company.
- A range of dollars or percentage of assets to be allocated to each type of investment.
- Specific quality requirements for each investment in order to be eligible for investment by the company.
- The process for the monitoring and evaluation of investments.
- The process for authorizing and executing purchases and sales.

Examiners prepared three analyses of the investment portfolio performance over a four-year period beginning in 1997. All three analyses factored out Wisconsin Reinsurance Co. ("WRC") stock holdings as it is a restricted stock. The analyses focused on the performance of stocks that the company actively manages.

The first analysis compared the performance of the company's stock portfolio to the performance of some S&P 500 indexes, and a hypothetical 5% rate of return as if the company would have invested in bank deposits or low risk government securities during that period. (As the company's December 1999 "investment policy" mentioned small-cap, medium-cap and large-cap stocks, the analysis used S&P indexes related to each class of stock, plus two aggregate S&P stock indexes.) The analysis uses an initial investment of \$10,000 for ease of comparison. The analysis is as follows:



This analysis showed that the company's investments have done poorly over the past four years even though the stock market overall has shown significant gains.

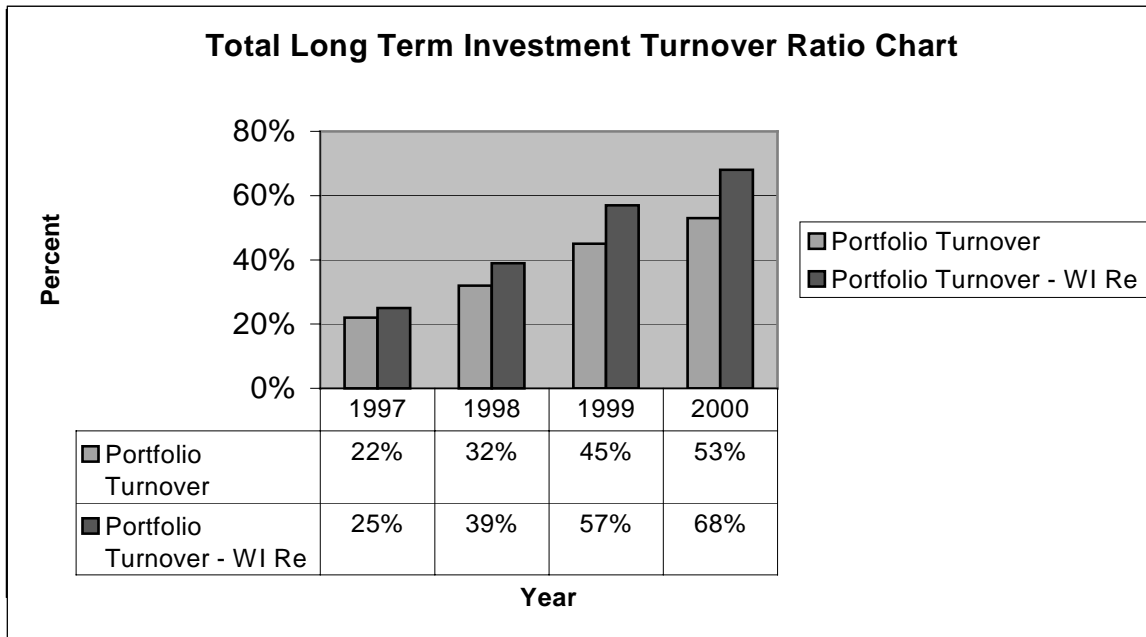
The second analysis reviewed the performance of the company's stock portfolio by comparing the Annual Statement value of their stock portfolio at year-end and the unrealized capital gains(losses) on those investments. The analysis is as follows:

	Total Portfolio		WRC Stock		Stock Portfolio - WRC Stock	
	Annual Statement Value	Unrealized Capital Gain(Loss)	Annual Statement Value	Unrealized Capital Gain(Loss)	Annual Statement Value	Unrealized Capital Gain(Loss)
Year						
2000	\$ 2,335,124	\$ (116,567)	\$ 777,920	\$ 577,920	\$ 1,557,204	\$ (694,487)
1999	2,182,602	(306,809)	623,200	423,200	1,559,402	(730,009)
1998	2,291,592	(84,515)	623,840	423,840	1,667,752	(508,355)

1997	2,203,242	(176,510)	447,200	247,200	1,756,042	(423,710)
4-Yr. Avg.	2,253,140	(171,100)	618,040	418,040	1,635,100	(589,140)

This analysis shows unrealized losses for the company's stock portfolio amounted to \$589,140, on average, over a four-year period, excluding unrealized gains on restricted stock of \$418,040. The analysis shows that the company's active investment portfolio has done poorly for four consecutive years.

The last analysis is a review of the company's investment activity each year over the last four years. The examiners calculated an investment portfolio turnover ratio for each of the years under examination and graphed the data. The portfolio turnover calculation is computed as the trading activity in the company's portfolio (the lesser of purchases or sales) divided by the average total assets during that year. This calculation is commonly used in the mutual fund industry.



This analysis shows a steady increase in investment turnover over the past four years. It also shows that 68% of the average investment balance in 2000 was either acquired or disposed. There was no evidence that company management performed significant research on each buy,

sell or hold decision. Transaction costs (commissions, etc.) reduced net investment earnings, and contributed to the company's poor investment performance.

It was noted that the Board of Directors was not adequately updated on the condition of the company's investment portfolio. There was no evidence of any reports to the board accurately showing the performance of Farmington's investment holdings and comparing them to any stock indexes. The board did receive a report on individual investments that were doing well; however, the poorly performing investments were not mentioned. It appears that the Board and management are not exercising due diligence on monitoring the performance of the company's investments. It is recommended that the company retain an independent investment advisor to develop a written investment plan, and that this written investment plan be submitted to this office for approval.

#### **Premiums in Course of Collection**

The company reported \$230,133 of premiums in the course of collection. The company's computer-generated reports for this account require many manual adjustments to arrive at the correct amounts for annual statement reporting. Examiners found the company used some 1999 amounts rather than 2000 amounts in making these adjustments; however, the errors did not result in a material misstatement of the balance.

The company pays its agent commissions once per year, after the November 1 annual renewal date. The proper statutory accounting principle is that the full commission on a policy is to be expensed at the inception of the policy period, regardless of whether the policyholder pays the annual premium in full, or by quarterly or semi-annual installments. The company established a liability for deferred commissions payable of \$35,997 at December 31, 2000, that represents the agent commissions related to deferred premium installments not yet received by that date, and improperly reduced the amount of commissions expense incurred by that amount. The \$35,997 should have been expensed in 2000, at the inception date of the policies, rather than in 2001 as the deferred installments were received. An adjustment of \$35,997 is made to decrease policyholders' surplus. It is recommended that the company expense the full agent commission

on every policy at the inception of the policy period regardless of the policyholders' payment mode.

The company permits policyholders to pay their policy premiums in quarterly or semi-annual installments. The company reported deferred installment premiums receivable on line 10.1 of the annual statement, "Premiums and agents' balances in the course of collection". The amount should have been reported on line 10.2, "Premiums, agents' balances and installments booked but deferred and not yet due". It is recommended that the company report deferred installment premiums receivable on the correct line of the annual statement, according to the NAIC's Annual Statement Instructions – Property and Casualty.

### **Unearned Premiums**

Examiners reviewed the company's records underlying its reported liability of \$1,086,586 for unearned premium reserve. As stated earlier in this report, all policies renew on November 1 annually, so the computer generated reports showing the calculation of unearned premium should show each policy's renewal date as November 1. Examiners found 57% of policies in the report with renewal dates earlier in the year, or dates in 1999 and 1998, which resulted in an understatement of the unearned premium reserve for those policies. The company agreed that these were errors in the computer records, and that November 1 was the correct renewal date. Examiners computed that the correct unearned premium reserve was \$1,121,297, an increase of \$34,711 over the company's reported number. An adjustment for \$34,711 is made to reduce surplus.

Also, in reviewing the company's calculation of the unearned premium reserve, examiners found a second error. The company allows a discount to policyholders who pay their annual premium in full; this has ranged from 10% to 20% during the period under examination, the amount was 10% for November 1, 2000 renewals. In 2000, about 72% of the premium was paid on an annual basis, the other 28% was paid in installments. To properly calculate the effect of these discounts on the unearned premium reserve, several manual adjustments are made from two computer-generated reports. For policies that renew November 1, but cancel before December 31, the company assumed that all these cancellations were to annual pay policies;

however in the absence of other information the company should assume that cancellations occur proportionately to annual and installment pay policies. Since the number of cancellations was small, there is no adjustment to the company's reported amount for this error. However, it is recommended that in the absence of documentation of actual amounts, for computation of unearned premium reserve the company should assume that policy cancellations occur proportionate to the volume of annual, semi-annual and quarterly payment modes.

Examiners identified numerous problems with the company's current computer system, including data errors and the need to make complex adjustments to computer-generated reports to arrive at the proper annual statement amounts. It is suggested that the company install improved computer software for controlling its policies and tracking deferred and unearned premiums.

### **Net Unpaid Losses**

This liability represents losses incurred on or prior to December 31, 2000, and remaining unpaid as of that date. The examiners performed a development of unpaid losses and compared that amount with the amount estimated by the company. The examiners developed this liability by totaling actual loss payments made through the development period on those losses incurred on or prior to December 31, 2000. To the actual paid loss figures was added an estimated amount for those 2000 and prior losses remaining unpaid at the time of the examination, if any. The loss development shows a deficiency at the time of the examination in the amount of \$97,385. As the reserves appear to be understated, an adjustment is being made to the net unpaid loss amount. This adjustment is reflected in the "Reconciliation of Surplus per Examination" section of this report. It was also noted when developing the reserves that the company did not establish an adequate IBNR (incurred but not reported) reserve for their liability claims. The company established \$8,500 for liability IBNR, which is well below the company's retention of \$25,000 on each liability claim. The company should establish an IBNR reserve for at least two liability claim retentions, which would increase IBNR reserve by \$41,500. An adjustment was made to reflect the increase in liability IBNR. The total adjustment to the loss reserve is \$138,835.

Examiners found a number of problems with the company's process for controlling unpaid claims and establishing the reserve. These include: A claim was held by an agent for a while before it

was reported to the company. There was one instance where a claim wasn't filed with the office until two months after it was reported to the agent.

- A number of open claims at year-end 2000 were not transferred to the open claims file in 2001.
- Four claims that had year 2000 claims numbers assigned to them were left out of the company's year-end 2000 loss reserve calculation .
- The company included two claims, for the same policy, in the same claim file.

The company does not require its agents to comply with the rules in the agents manual including the rule that new policies are to be sent into the office in a timely manner.

The following recommendations relate to improvements on claims procedures.

- It is recommended that the company enforce its agents' compliance with guidelines set forth in the agency manual concerning claims reporting practices.
- It is recommended that the company transfer open claim balances from year to year.
- It is recommended that the company include all current year assigned claims in the loss reserve calculation.
- It is again recommended that the company maintain separate claim files for each claim made against the company and that these claim files and all related documentation be kept separate from other cash disbursements of the company.
- It is suggested that the company obtain computer software that will maintain the loss register more efficiently and without error.

### **Furniture and Equipment**

The company included EDP hardware with their non-admitted Furniture and Equipment balance on the annual statement. EDP hardware should be reported on line 15 on the Asset page, and may be admitted. An adjustment and reclassification of \$3,347 was made to account for this misstatement. It is recommended that the company report the admitted portion of their

EDP equipment on the correct line on the balance sheet according to the NAIC's Annual Statement Instructions-Property and Casualty.

### **Taxes Licenses and Fees**

The company reports amounts withheld for others as a part of the taxes, licenses and fees line item on the annual statement. The company reported \$1,989 of employee payroll taxes as taxes, licenses and fees. According to the NAIC's Annual Statement Instructions-Property and Casualty, the employee portion of payroll taxes should be reported as amounts withheld for others on the annual statement. A reclassification of the \$1,989 will be made to properly reflect the amounts reported for amounts withheld for others. Also, it is recommended that the company properly report amounts withheld for others in accordance with the NAIC's Annual Statement Instructions-Property and Casualty on all future annual statements.

The examiners also found other expense items as a part of the taxes, licenses and fees line item on the annual statement. The company reported \$2,216 of various monthly bills payable as taxes, licenses and fees. Other expenses, not including licenses, taxes and fees, are defined in the NAIC's Annual Statement Instructions-Property and Casualty and are to be reported on the other expenses line on the Annual Statement. A reclassification of the \$2,216 will be made to properly reflect the other expenses owed by the company. Also, it is recommended that the company properly report other expenses in accordance with the NAIC's Annual Statement Instructions-Property and Casualty on all future annual statements.

After further review of the taxes, licenses and fees balance the examiners' found that the company's manager was receiving \$300 a month for a travel allowance that was not being reported as a wage on his W2 form. The company was recording the accrual for this expense under the taxes, licenses and fees line on the annual statement. Due to the fact this amount is not a reimbursement for actual mileage the manager has expensed, but is an allowance, the company must include this as compensation for the manager. It is recommended that the company include the travel allowance as compensation to the manager on his federal W2 form filing.

## **VIII. CONCLUSION**

The examination of the Farmington Mutual Insurance Company resulted in 32 recommendations, 9 of these repeated from the prior examination, 3 suggestions, 9 adjustments, and 4 reclassifications. The adjustments resulted in an aggregate decrease to surplus of \$279,154.

The company has consistently incurred underwriting losses except for the current year. Recommendations were made concerning documentation of risks, adhering to underwriting guidelines and rates.

Another significant portion of the recommendations is related to the invested assets of the company. The company's investment results are a concern. The investment portfolio has performed poorly and management of the portfolio is almost non-existent. The Board of Directors does not receive adequate reports documenting the performance of the company's investments. This shows a lack of fiduciary duty on the part of the Board of Directors and the Company's manager.

Along with the managing of investments problem and poor underwriting results, the company does not have adequate accounting controls or procedures over its accounts and records. A significant portion of the exam recommendations related to inadequate documentation. This includes proper control of cash accounts and records, claim history, etc. Also, specific suggestions were made to obtain adequate software to aid them with documentation of various accounts. Overall, the company needs to improve its recordkeeping and documentation of transactions.

Due to the problems previously stated and the company's intentions to grow in premium volume, the company should consider hiring an additional employee who is professionally capable of handling the company's problems in accounting and record-keeping, including investments. By hiring a new employee the company has the opportunity to alleviate some of their weaknesses, strengthen their company structure and become more self-reliant.

## IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 21 - Annual Statement—It is again recommended that the company properly complete and include all required information on all future annual statements.
2. Page 21 - Management and Control—It is again recommended that the company more adequately segregate the performance of the daily activities of the company in order to mitigate this internal control weakness.
3. Page 22 - Management and Control—It is recommended that the company evaluate its internal controls structure and the capacity of current employees to handle additional work, and consider establishing an additional position with duties in accounting and computer systems
4. Page 22 - Underwriting—It is suggested that the company review its rates annually, and regularly review competitors' rates as part of that process.
5. Page 22 - Underwriting—It is recommended that the company begin a requirement for submission of photographs with all applications and on inspected risks.
6. Page 23 - Underwriting—It is recommended that the company enforce agents' compliance with guidelines set forth in the agency manual concerning the reporting of newly written policies.
7. Page 23 - Accounts and Records—It is again recommended that the company require that two signatures are required for all checks exceeding an amount established by the board.
8. Page 23 - Accounts and Records—It is recommended that someone other than the manager reviews each month's reconciliation of the checking account, pursuant to s. 601.42(3), Wis. Stat.
9. Page 23 - Cash and Short-Term Investments—It is then recommended that money market funds that are not found on the NAIC Securities Valuation Office's - "U.S. Direct Obligations Exempt List," the "U.S. Direct Obligations/Full Faith & Credit Exempt List," or the "Class 1 List" be listed on Schedule D – Part 2 on the annual statement in accordance with the NAIC's Annual Statement Instructions-Property and Casualty.
10. Page 23 - Unclaimed Funds—It is recommended that the company comply with ch. 177, Wis. Stat., as regards to unclaimed funds, and that a liability for unclaimed funds be established in future statutory annual statements to account for all checks outstanding for over one year.
11. Page 24 - Invested Assets—It is again recommended that the company comply with s. 610.23 Wis. Stat., on the custody and control of its invested assets.
12. Page 24 - Invested Assets—It is recommended that, within 30 days of the adoption of this report, the company open a custodial account that has been approved by this office, and within 60 days of the adoption of this report all securities held by brokers and held in the current trust account be transferred to the new custodial account.
13. Page 24 - Invested Assets—It is further recommended that the custodial/safekeeping agreement entered into include the requirements as established by the NAIC Examiners Handbook, which includes the following:

a) The custodian is required to hold securities separate and distinct from the other deposits with the custodian so that at all times they may be identified as belonging solely to Farmington Mutual Insurance Company;

b) The custodian is obligated to indemnify the company for any loss of securities of the insurance company in the bank or banking and trust company's custody occasioned by the negligence or dishonesty of the bank or banking and trust company's officers or employees, or burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damage or destruction; and

c) In the event that there is a loss of the securities for which the bank or banking and trust company is obligated to indemnify the company, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced.

14. Page 25 - Invested Assets—It is again recommended that the company maintain adequate documentation whereby justification for the rating assigned to the investment can be ascertained.
15. Page 25 - Invested Assets—Furthermore it is recommended that the company submit the proper filings, for all securities, on Schedule D in the Annual Statement, acquired by the company since the time of the conversion, to the NAIC Securities Valuation Office for those securities not listed in the Valuations of Securities manual.
16. Page 27 - Invested Assets—It is recommended that the company create a system to accurately monitor and record investment transactions, reconcile company investment records to custodial accounts monthly, and correctly report the number of shares owned and correct NAIC SVO values on the annual statement.
17. Page 27 - Invested Assets—It is recommended that the company complete Schedule D – Part 4 correctly in all future annual statements.
18. Page 28 - Invested Assets—It is again recommended that the company establish a formal written plan for the company's investments.
19. Page 31 - Invested Assets—It is recommended that the company retain an independent investment advisor to develop an investment plan, and that this written investment plan be submitted to this office for approval.
20. Page 31 - Premiums in Course of Collection—It is recommended that the company expense the full agent commission on every policy at the inception of the policy period regardless of the policyholders' payment mode.
21. Page 32 - Premiums in Course of Collection—It is recommended that the company report deferred installment premiums receivable on the correct line of the annual statement, according to the NAIC's Annual Statement Instructions – Property and Casualty.

22. Page 33 - Unearned Premium—It is recommended that in absence of documentation of actual amounts, for computation of unearned premium reserve the company should assume that policy cancellations occur proportionate to the volume of annual, semi-annual and quarterly payment modes.
23. Page 33 - Unearned Premium—It is suggested that the company install improved computer software for controlling its policies and tracking deferred and unearned premiums.
24. Page 34 - Net Unpaid Losses—It is recommended that the company enforce its agents compliance with the guidelines set forth in the agency manual concerning claims reporting practices.
25. Page 34 - Net Unpaid Losses—It is recommended that the company transfer open claim balances from year to year.
26. Page 34 - Net Unpaid Losses—It is recommended that the company include all prior current year assigned claims in the loss reserve calculation.
27. Page 34 - Net Unpaid Losses—It is again recommended that the company maintain separate claim files for each claim made against the company and that these claim files and all related documentation be kept separate from other cash disbursements of the company.
28. Page 34 - Net Unpaid Losses—It is suggested that the company obtain computer software that will maintain the loss register more efficiently without error.
29. Page 34 - Furniture and Equipment—It is recommended that the company report the admitted portion of their EDP equipment on the correct line on the balance sheet according to the NAIC's Annual Statement Instructions-Property and Casualty.
30. Page 35 - Taxes Licenses and Fees—It is recommended that the company properly report amounts withheld for other in accordance with the NAIC's Annual Statement Instructions-Property and Casualty on all future annual statements.
31. Page 35 - Taxes Licenses and Fees—It is recommended that the company properly report other expenses in accordance with the NAIC's Annual Statement Instructions-Property and Casualty on all future annual statements.
32. Page 35 - Taxes Licenses and Fees—It is recommended that the company include the travel allowance as compensation to the manager on his federal W2 form filing.

## **X. ACKNOWLEDGMENT**

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

<b>Name</b>	<b>Title</b>
Mark Lasowski	Insurance Financial Examiner

Respectfully submitted,

John Litweiler  
Examiner-in-Charge